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IN THE

Supreme Court of the United States

October Term, 1969

No. 1487

ARMSTRONG JONES & Co. and THOMAS W. ITIN,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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TO THE HONORABLE THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The Petitioner seeks a writ of certiorari to review a judgment of the United States Court of Appeals for the Sixth Circuit. That court, by decision and order dated January 23, 1970, unanimously affirmed an order of the Securities and Exchange Commission dated October 3, 1968, which order revoked the registration of Petitioner, Armstrong Jones & Co. as a broker and dealer under the Securities and Exchange Act of 1934, and expelled said Petitioner Armstrong Jones & Co. from membership in the National Association of Securities Dealers, Inc. and the

Detroit Stock Exchange; and which order further barred the Petitioner Thomas W. Itin from association with any broker-dealer, except that upon appropriate showing Petitioner Itin may become associated with a broker or dealer in a non-supervisory capacity after one year, subject to adequate training and supervision; and which order further barred a former officer of Petitioner from association with any broker-dealer; and which order further discontinued the proceedings as against three other named defendants and censored a fourth.

Opinions Below

The opinion of the Court of Appeals appears as appendix A-1 to this Petition, and the order amending it, dated February 12, 1970, appears as Exhibit A-2. The opinion and order of the Securities and Exchange Commission and its opinion on reargument appears as appendices A-3 and A-4 to this Petition.

The opinion of the Securities and Exchange Commission has been published as Securities Exchange Act Release #8420. The opinion of the Court of Appeals appears at *CCH, Federal Securities Law Rep.* #92,562.

Jurisdiction

The opinion and order of the Court of Appeals was entered January 23, 1970, and is annexed Appendix A-1 to this brief. On February 12, 1970, said opinion and order was amended by order of that court, correcting three citations contained therein. Said order of amendment is contained in this brief as Appendix A-2.

The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

(1) Did the Court of Appeals err in holding that Petitioners were not in any way denied due process pursuant to Amendment V of the United States Constitution, by the conduct of the Respondent Securities and Exchange Commission, and the Hearing Examiner, in refusing to disclose to the Petitioners, prior to the commencement of the hearing, the names of the witnesses that the Respondent intended to call, and the content of any statements of such witnesses in the possession of the Respondent, and by denying the Petitioners' application for other discovery of the Respondent's case.

(2) Did the Court of Appeals properly affirm the order and opinion of the Respondent that the intrastate exemption from registration, under Sections 3(a)(11) of the Securities Act of 1933, is unavailable if only one sale is made to non-residents.

(3) Did the Court of Appeals err in affirming the holding of Respondent and in concluding that there is substantial evidence in the record to support its conclusion that the Petitioners wilfully made a sale to non-residents of the State of Michigan, and that they accepted orders or indications of interest from non-residents for execution in the after-market and then "caused" the initial issue to be resold to non-residents in the "after-market" by opening the market at an artificially high price so as to "draw" the original issue out of the hands of the initial subscribers before said stock could "come to rest."

Rules and Statutes Involved

This Petition is submitted on the premise that the rules of the Securities and Exchange Commission regarding disclosure of the Commission's witnesses and witness statements is so restrictive as to violate due process. It is asserted that Rule 11.1 is overly restrictive. Said Rule appears at 17 C.F.R. §201.11.1 and provides as follows:

> "After a witness called by the attorney for the interested division of the Commission has given direct testimony in a hearing, any other party may request and obtain the production of any statement, or part thereof, of such witness, pertaining to his direct testimony, in the possession of the division, subject, however, to the limitations applicable to the production of witnesses' statements under the Jencks Act, 18 U.S.C. § 3500."

The second statute in question, is the proper construction of the intrastate exemption in the Securities Act of 1933, which section is subdivision 11 of Section 3(a), which provides as follows:

> "Sec. 3(a) Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities:
>
> (11) any security which is part of an issue offered and sold only to persons resident within a single state or territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within such State or Territory."

Statement

This is a Petition for a writ of certiorari to the U. S. Court of Appeals, Sixth Circuit, which by order and decision dated January 23, 1970, unanimously affirmed a determination of the Securities and Exchange Commission, ("S.E.C.") that the registration of a securities broker-dealer, Armstrong, Jones & Company ("Armstrong, Jones") should be revoked and its principal, Thomas W. Itin ("Itin"), be barred from the securities business (except that after one year and proper training he would be permitted to apply for readmittance in a non-supervisory capacity).

The proceeding essentially involves the sale of securities of two different, unrelated companies. The first company was the Alexander Hamilton Life Insurance Company, a Michigan corporation ("Hamilton Life") which undertook to sell its unregistered common stock in Michigan only, pursuant to the intrastate exemption from the registration requirements of the Securities Act of 1933. Armstrong, Jones acted as a participating dealer in that offering. The second company was the Windsor Raceway Holdings, Limited ("Windsor Raceway") which sold securities registered with the S.E.C. through Armstrong, Jones as the underwriter.

This proceeding was initiated by the S.E.C. with the charge that the Petitioners, and several other principals no longer active in the litigation, were guilty of abject fraud in connection with a suspected manipulation of the market for Hamilton Life stock, between April and September, 1964, and with certain other violations, including: (1) offering for sale in interstate commerce, the unregistered shares of Hamilton Life; (2) failing to disclose that Hamilton Life

and Armstrong, Jones (Petitioner) were under common control; (3) making unwarranted price predictions concerning the Hamilton Life stock; and (4) prematurely mailing confirmations of Windsor Raceway security sales without first "firming-up" previously obtained indications of interest. Neither Hamilton Life nor Windsor Raceway were involved in the proceeding.

Prolonged public hearings were held which lasted from May 23 to July 18, 1966, and which resulted in an opinion of the Hearing Examiner sustaining all the charges. In substance the opinion was premised on the following findings: (1) with regard to the intrastate exemption, that three sales were made to Michigan residents as fronts for non-residents, and that in connection with one of those sales Petitioners should have been able to detect the scheme. (2) With regard to the common control issue, he determined that two directors and officers of Hamilton Life had a controlling influence over the Petitioner Armstrong, Jones during part of the period in question by reason of their being directors of and having an equity interest in said Petitioner. (3) With regard to the unwarranted price predictions issue, there was evidence that a salesman of Petitioner, unbeknownst to management, had made certain price predictions concerning Hamilton Life stock, although Petitioners did not do so. (4) Finally, he determined that indications of interest must be "firmed-up" before confirmations can be mailed. Evidence of trade practice was presented on this issue.

The S.E.C. ordered a review of all issues involved in the proceedings, and in its Findings, Opinion and Order dated October 3, 1968, it supported and sustained the Hearing Examiner on the four "other violations", i.e. no intrastate

exemption, lack of disclosure of common control, unwarranted price predictions, and premature confirmations, but refused to consider the main manipulation issue and dropped the charges against Armstrong, Jones' employee in charge of trades. Also it reversed the Hearing Examiner's finding that there was a concert of action, and accordingly dropped the charges against the Hamilton Life principals (except for one which it censored on account of his involvement in two intrastate transactions.) On reargument it reaffirmed its findings.

The Hearing Examiner revoked the registration of Armstrong, Jones and barred Itin from association with any broker-dealer for one year, because of the import of their "manipulative activities." The full Commission found no manipulative activities yet sustained the same sanctions because it held the remaining four violations: "demonstrate gross indifference to the requirements of the securities laws and are inconsistent with their continued engagement in the securities business."

The Court of Appeals for the Sixth Circuit initially stayed enforcement of the Commission order, but in its opinion found "substantial evidence in the record" for each of the four violations. Additionally it held that, while it might have imposed different sanctions, it was not prepared to disturb the sanctions imposed by the full Commission.

REASON RELIED ON FOR GRANTING THE WRIT

I.

The Manner in Which the S.E.C. Conducted Its Investigation and Proceeded With the Hearing Deprived the Petitioner of Due Process.

The principal reason why this Court should grant Petitioners' application and consider this case is that, in addition to the many substantive errors in the decision of the Circuit Court, the initial S.E.C. investigation and subsequent hearing was fraught with discriminatory and unjust conduct, effectively denying the Petitioners due process.

The principal defect in the proceedings involve the Commission's refusal to give Petitioners a list of the respective witnesses prior to calling them to the witness stand, and refusing to afford Petitioners any discovery whatsoever of the S.E.C.'s charges and case. The S.E.C.'s investigation covered a considerable period of time; and, aided by the power of the subpoena, the investigators interrogated ex parte numerous prospective witnesses in order to support its suspicion that there had been manipulation in the sale the Alexander Hamilton Life Insurance Co. stock. The testimony of these witnesses was taken under oath and under circumstances in which said witnesses were not represented by counsel, leading questions were asked by the investigations and such testimony was not subjected to any cross examination. Later, when the witnesses were called to testify at the hearing, many months after the initial interrogation, they were first shown sworn statements that they had previously given and signed at the conclusion of

their interrogations. The Commission, sustained by the Hearing Examiner, refused to reveal in advance the names of such witnesses or to make available the sworn statements until after the direct examination was concluded (Tr. 7-8; 528; 688-95; 1325; 1553-4; 1558-9; 1914-15). Respondents were seriously hindered in their defense of this case by these practices.

The Circuit Court disposed of this issue with the finding that: "Our examination of the record does not indicate that petitioners were prejudiced by the Commission's rulings with regard to the witnesses' names or statements. We therefore find no basis for the claimed denial of a fair hearing." Additionally the Court below ruled that Petitioner was not even entitled to the protection of the Jencks Act (18 U.S.C. §350), although it was afforded the rights therein provided. This conclusion fails completely to reflect an appreciation of the significance of a broker-dealer revocation proceeding, and the basic rights of the parties therein accused, who are faced with expulsion from the industry.

When a broker-dealer is threatened with the possible revocation of his registration, it is basic that his counsel should at least have the opportunity to prepare a defense with some knowledge of what evidence will be introduced against his client. While the administrative agency is charged with protecting the public interest, this objective cannot be allowed to over-shadow the rights of those subject to an investigation. The effect of a public investigation into manipulation or fraud, regardless of the outcome, is disastrous on a respondent's business and his reputation, and of course the purpose of the proceedings was to expel these Petitioners from the industry. Under such circumstances it is essential to insure procedural fair play. As was

stated in the case of *Amos Treat & Co.* v. *Securities and Exchange Commission,* 306 F.2d 260, 267 (D.C. Cir. 1962):

> "Enough has been said to demonstrate the basis for our conclusion that an administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness. Only thus can the tribunal conducting a quasi-adjudicatory proceeding meet the basic requirement of due process."

Petitioners here urge that in a proceeding as serious as a broker-dealer revocation, which has many criminal implications, and which spells continued existence or nonexistence for the registrant, procedural fairness cannot exist unless the prosecuting agency is held to at least the same standard which this Court has set for criminal prosecutions in *Brady* v. *Maryland,* 373 U.S. 83 (1963), where the Court held:

> "We now hold that the suppression by the prosecution of evidence favorable to an accused upon request violates due process where the evidence is material either to guilt or to punishment, irrespective of the good faith or bad faith of the prosecution." 373 U.S. 87

Had a proceeding of this nature been brought in a district court, there seems little doubt that Petitioners would have been afforded the discovery rights it sought. The Federal Rules of Criminal Procedure provide that the court may compel the Government to submit to discovery of material in its possession where the same is material to the defendant's preparation, and the request is reasonable. (F.R.C.P. Rule 16) Thus in a securities fraud case brought

in the district court, the accused, consistent with *Brady* and the Federal Rules, is afforded a broad range of pretrial discovery into the Government's case. *United States* v. *Wolfson, et al.*, 289 F. Supp. 903 (S.D.N.Y. 1968). In an agency proceeding, however, where the consequences are no less catastrophic, the position of the S.E.C. is that the accused is entitled to no discovery of the S.E.C.'s investigation and witness statements until, in accordance with the Jencks Act, after the respective witnesses have testified. *Morris J. Reiter,* 39 S.E.C. 484 (1959); *F. S. Johns & Co., Inc.,* Securities Exchange Act Release No. 7972, pp. 15-16 (Oct. 10 1966) *aff'd Dlugash* v. *S.E.C.,* 373 F. 2d 107, 110 (2d Cir. 1967); S.E.C. Rules of Practice §11.1. No justifiable reason can be formulated, why the S.E.C. can continue to deny respondents those elementary procedural safeguards which are now elementary in the federal courts. The irony is that these Rules were drafted in 1935 from the then existing federal civil procedural rules, but have remained essentially unchanged since, while the federal rules, civil and criminal, have undergone dramatic revisions to reflect modern concepts of basic constitutional protection. *Freeman, Administrative Procedures,* 22 *Business Lawyer* 891, 898-99 (April 1967)

This practice of the Commission is especially insidious in a proceeding of this nature because of the tremendous imbalance in investigatory tools and resources. The S.E.C. interviewed hundreds of prospective witnesses in order to uncover three who allegedly made out-of-state purchases, out of the total of 8,000 original subscribers, and approximately a dozen who testified to price predictions. Under such circumstances Petitioner could not adequately prepare its defenses by interviewing witnesses itself—it

must know what it will be confronted with. Additionally the Commission's procedures were intolerable in that it was initially able to subpoena witnesses to be interviewed *ex parte,* with several Commission representatives present, but no counsel for Petitioners or the witness himself. Without safeguards against leading questions and the like, the Commission then succeeded in obtaining signed statements which by use on the eve of said witness' testimony, to refresh the recollection of the witness, effectively limited the testimony. This was all done *ex parte* and in secret, denying Petitioner any opportunity to insure that the original testimony would be free, candid and accurate as well as truthful, and denying Petitioners a meaningful way to prepare a defense. In the face of this procedure, the *Jencks Act* affords respondent little comfort or protection. By the time the witness has testified as urged by the S.E.C., the damage is done, and a respondent's opportunity to prepare for it is virtually non-existent. "The only reasonable time for the prosecution to reveal his evidence is during the pretrial period." *Comment, Prosecution's Constitutional Duty to Reveal Evidence to the Defense,* 74 Yale L.J. 136, 149 (1964)

The whole constitutional premise for the *Brady* decision, and the line of so-called "suppression cases" appears to be that there normally exists a dramatic disparity between the prosecution's and the defense's ability to obtain evidence, which disparity, when aggravated by the denial of discovery, infringes upon the defendant's ability to obtain a fair trial and infringes upon due process. *Id.* at 142-43 As has been observed by some commentators, this disparity is often greater in an administrative "quasi-criminal" proceeding, and the constitutional demand is certainly as great:

> . . . an obvious second difference between court and agency proceedings, one indicating the advisability of discovery in administrative proceedings, is that in the latter only one of the litigants has the legally constituted capability of entering the trial equipped with extensive information and with power to obtain further information as needed. Certainly fairness demands an effort to render the respective fact-finding powers of the litigants more nearly equal. After all, the Supreme Court's recognition that fairness inheres in the deposition-discovery procedure was premised on the necessity of *mutual* knowledge of facts gathered by *both* parties. The agencies' favorable position is not justified by their status as government bodies seeking to vindicate the "public interest." They are subject to discovery in the courts . . . . [citing *United States* v. *Procter & Gamble,* 356 U.S. 677, 682 (1958); *Hickman* v. *Taylor,* 329 U.S. 495 (1947)] *Montgomery, Discovery in Federal Administrative Proceedings,* 16 Stan. L. Rev. 1035, 1060 (1964)

The force and influence of the government under these circumstances, completely frustrates any reasonable opportunity for any respondent to prepare its defenses adequately. Under such circumstances due process requires that the rules of discovery available in a court be similarly available in an agency broker-dealer revocation proceeding.

II.

The Court of Appeals Erroneously Concluded That There Is "Substantial Evidence in the Record" to Support Each of the Charges Against Petitioner.

These proceedings are quasi-criminal in nature and the result being appealed is a virtual business death sentence to the appealing Petitioners. Armstrong Jones has had its broker-dealer license revoked by the S.E.C., and Itin has been barred from engaging in the securities business for a year, and thereafter can only find related work in a non-supervisory capacity. The stigma of this fraud "conviction" however, will effectively deny him even a non-supervisory position in the industry. Accordingly, the protective provisions of the United States Constitution and the Federal criminal code should be available to the respondents in no less a degree than such are available to a common criminal proceeding, and the charges of fraud and wilful wrongdoing must be supported by substantial evidence. Petitioners challenge the Court of Appeal's finding that the record contains such "substantial evidence" regarding any of the four charges. Petitioners assert that there was no competent evidence to support the four charges against them.

A) *The Intrastate Exemption Charge*

The Court of Appeals initially adopted Securities Act Release No. 4434 (1961), that "any" sale that escapes the bounds of the state in question, voids the exemption completely, and exposes all participants with the same liability as if they ignored the security laws altogether. This rule,

which was created by the S.E.C., completely negates the intrastate exemption and makes all participants insurers of all sales. The same Sixth Circuit, only six months before deciding this case, reviewed the legislative history of the exemption and determined that it was designed to apply to distributions "predominantly intrastate in character" and was designed: "to apply to those securities which were being supervised effectively by State regulation. S. Rep. No. 47, 73rd Cong., 1st Sess. 4 (1933) and H.R. Rep. No. 85, 73rd Cong., 1st Sess. 5 (1933). Section 3(a)(11) was designed to exempt these State regulated securities from the application of the Act." *Chapman* v. *Dunn.*, 414 F. 2d 153, 156-57 (6th Cir. 1969). Professor Loss has also written that a common sense "predominantly intrastate" rule was intended by Congress:

> "Yet it is difficult to believe that Congress intended to make the issuer an absolute insurer of every offeree's residence (or—worse—his *animus manendi*) and of every salesman's integrity. Unless the standard is one of due care—which includes reasonable supervision of all selling agents and may well require something more than an automatic acceptance of the buyer's representation—the exemption is virtually read out of the statute. Perhaps it should be. But that presumably is why Congress sits." 1 *Loss, Securities Regulation* 604-05.

See also, *McCauley, Intrastate Securities Transactions under the Federal Securities Act,* 107 U. Pa. L. Rev. 937, 941 (1959).

Accordingly this Court should grant certiorari to set at rest the long debated meaning of the intrastate exemption.

Hamilton Life was at the time of these proceedings totally intrastate. All its property was within the State of Michi-

gan and its right to do business as an insurance company existed only in the State of Michigan, where it was regulated both by the State's Insurance Commission and by the State's Securities Commission. It had no property or right to do business outside of the State of Michigan.

The S.E.C. introduced evidence of three sales to Michigan residents acting as fronts for non-residents during the distribution period. Only one was alleged to have involved Petitioners. The single transaction involving Petitioners was one in which three Chicago residents formulated a scheme or plan to purchase 1,000 shares through an uncle, a bona fide resident of Michigan. The uncle and the nephew, both in writing and orally, stated to Itin on several occasions that the shares were being purchased by and for the account of the uncle, and the testimony was that the purchasers devised the scheme because Itin refused to sell them stock directly. The S.E.C., as affirmed by the Court of Appeals, held that nevertheless the Petitioners should have more carefully guarded against such a scheme. Clearly a finding that a single sale totalling 1,000 shares of its common stock out of more than 8,000 bona fide resident transactions involving 2,182,000 shares sold or .0045 of 1% of the number of shares sold, constituted an "extensive violation", flies directly in the face of the Congressional history establishing that Congress intended that the Section 3(a)(11) exemption was to be available to companies such as Hamilton Life which was "predominantly intrastate in character". Hamilton Life was virtually 100% intrastate.

As part of the intrastate exemption question, the Court of Appeals found that there was substantial evidence that Petitioners "sought" interstate purchases for execution in

the "after-market" and that this, combined with the $7 opening market price, had the effect of preventing the initial intrastate distribution from coming to rest.

Initially the hearing examiner found that the entire intrastate issue had in fact come to rest in the hands of bona fide residents of Michigan, on the grounds that: (1) the subscription form required each subscriber to attest that he was a bona fide resident of Michigan and that he was purchasing for his own account and for investment; (2) that the offering was sold in small blocks; (3) that no insiders sold any shares in the relevant period; (4) that the Michigan Corporate Securities Commission and the Michigan Insurance Commission, required a rescission offer to all subscribers because the offering was over subscribed; and (5) that all sales in the after market, after trading had commenced came from small original investors who were conducting normal trading with their brokers.

The full Commission reversed the Hearing Examiner on this point, and ignored all five of these reasons. It held rather that the issue did not come to rest because Petitioners accepted indications of interest from non-residents during the distribution period, for execution in the after market, and opened the market too high—at $7. The combination, it was asserted, had the effect of drawing the original shares out of the hands of the initial purchasers, and preventing the issue from "coming to rest".

The trouble with the Commission's conclusion is that no evidence was introduced that Petitioners ever initiated any of the out-of-state indications of interest, or was in any way responsible for the initial $7 price. Indeed the proof was that the $7 price, if anything, was low, and that it was

not to Petitioners' advantage since indications of interest at below $7 were lost. Additionally the proof is that Petitioners' never approached an initial resident subscriber for the purpose of persuading him to sell his shares.

Additionally, the full Commission's theory is unsupported by any authority. Absent the existence of an interstate distribution scheme, it has never before been held that interstate sales in the after-market are illegal or otherwise effect the initial distribution. In all previous cases involving the intrastate exemption where the Commission has found an offering not to have come to rest, there was convincing proof that a large number of purchasers were not bona fide members of the public, but were rather professional brokers, dealers, controlling persons or large insiders who merely purchased initially for the purpose of making quick sales upon a subsequent rise in the market price. *Brooklyn Manhattan Transit Corp.*, 1 S.E.C. 147 (1935); *Lewisohn Copper Corp.*, 38 S.E.C. 226 (1958); and *Ned J. Bowman Company*, 39 S.E.C. 879 (1960). Here however, the facts are to the contrary. Thus the applicable legal principles support the Hearing Examiner's finding, which the full Commission overruled, and do not support the full Commission's finding, as affirmed by the Sixth Circuit.

B) *The Common Control Error*

The Sixth Circuit also found "substantial evidence to support [the] factual finding of common control" of Armstrong, Jones and Hamilton Life, which was not disclosed by the former.

The issue relates to the fact that two directors and officers of Hamilton Life were also directors of Armstrong, Jones for a short period of time and for a comparable

period they, plus one other, had a financial interest in it. Every witness who testified on the subject testified that Armstrong, Jones was controlled by Itin and by no one else. Armstrong, Jones was a small closed non public corporation and was at all times directed and run by Itin. Thus any disclosure of common relationship would have had to be accompanied by a disclaimer of control, and would have been innocuous and immaterial.

The SEC has conceded many times that control is a factual issue, and it should not now be entitled to ignore the entire uncontradicted and uncontraverted testimony in this record and find common control by administrative fiat. This result violates every tenet of due process of law.

Additionally, it is significant that all the facts concerning any relationship was fully disclosed to the Detroit Stock Exchange, The Securities and Exchange Commission and the Michigan Corporate Securities Commission, so no intent to deceive or hide can be alleged. At the very most, this is a technical argument which we do not believe involved a violation at all and certainly does not warrant the sanction of revocation.

C) ***The Indication of Interest Error***

The last violation which the Court of Appeals found was supported by "substantial evidence" involved mailing confirmations for Windsor Raceway securities, without "firming up" previously obtained "indications of interest."

Windsor Raceway filed a registration statement with the S.E.C. on October 23, 1964 and the S.E.C. declared it effective on December 21, 1964. During the so-called waiting period, Armstrong, Jones' salesmen mailed preliminary prospectuses, sometimes called "red herring" prospectuses,

to customers. Thereafter the salesmen telephoned such customers who had received the preliminary prospectuses and discussed the offering. During these telephone conversations the salesmen accepted from such customers what are considered in the jargon of the underwriting business to be "indications of interest" in purchasing Windsor Raceway securities. Following the effectiveness of the registration statement Armstrong, Jones mailed out confirmations, together with final prospectuses, to all such customers who had previously given indications of interest in purchasing the Windsor Raceway security.

The S.E.C. contended that the sending out of these confirmations, together with the final prospectuses, to such customers whose previously given indications of interest had not been "firmed up" constituted a fraud and a violation of the broker-dealer bookkeeping regulations. The Court of Appeals again ruled that there was substantial evidence in support of this contention.

It was Petitioners' practice to permit any such customer to cancel the transaction after receiving confirmations and before January 11, 1965, the date when the issue was closed. On advice of counsel and in order to avoid the credit restrictions of the Exchange Act (Exchange Act §7 and Regulation T) providing that credit can not be extended beyond seven business days, Armstrong, Jones sent out telegrams to all such customers who had not paid for the Windsor Raceway security, informing them that the security would be sold if not paid for by January 19, 1965. No customer lost any money by reason of the use of this sell out procedure.

The uncontroverted and only testimony in this record is that this Windsor Raceway offering was sold precisely the

way every other underwriting is conducted in the United States. Underwriters do not firm up indication of interest previously taken or accepted because such a procedure would not be feasible and in most underwritings would be physically impossible. The S.E.C. completely ignored the expert evidence to this effect, and failed to introduce any evidence to the contrary.

This procedure is dictated by the wording of sections 2(3) and 5 of the Securities Act. The concept of an indication of interest is not clearly defined in the statute. What the statute does do is to create a difficult anomoly for underwriters. Section 5, in substance, says no person can sell a security unless a registration statement is in effect. Section 2(3) says that a sale includes a contract of sale. Following the filing of a registration statement and before its effectiveness, Section 5 permits oral offers and written offers made by means of a Section 10 prospectus. Thus if a salesman sends a preliminary Section 10 prospectus, which is an offer to sell, and receives or accepts from such customer an order to purchase, a contract would result, in violation of Section 5. Accordingly, there has grown up in the securities business the practice of only taking indications of interest from customers who have received the preliminary prospectus, as such does not constitute a contract of sale and does not result in a violation. Obviously such indication of interest is given with respect to the previously received offer to sell made by the preliminary prospectus. It is considered by industry practice as an open offer to purchase, which can be accepted by sending a final prospectus, together with a confirmation, after the effective date of the registration statement and without more.

The testimony in this record, which is uncontroverted, clearly establishes that what was done in the Windsor Raceway underwriting is exactly in accordance with this accepted industry procedure and could not constitute a violation of any of the Securities Laws, including the fraud and bookkeeping provisions. The Court of Appeals' ruling that the record supported the S.E.C.'s finding of a violation is completely unfounded and cannot be allowed to stand.

III.

The Sanctions Imposed by the S.E.C., and Sustained by the Court of Appeals, Constituted an Abuse of Discretion.

The Hearing Examiner revoked the registration of Armstrong, Jones and barred Itin from association with any broker-dealer for one year, because of the import of their "manipulative activities." The S.E.C. found no manipulative activities yet sustained the same sanction because it held the remaining four violations: "demonstrate gross indifference to the requirements of the securities laws and are inconsistent with their continued engagement in the securities business." The Sixth Circuit, in review of the sanctions, ruled that "while we might have imposed different sanctions . . . our review of the record discloses no abuse of discretion on the part of the Commission, and its determination will therefore not be disturbed."

This is too simplistic an endorsement of the S.E.C.'s exercise of its discretion. It is incumbent upon the S.E.C. to find that the sanctions imposed are fair and just, in the public interest, and in no way arbitrary or capricious. *Shuck* v. *S.E.C.*, 264 F.2d 358, 362 (D.C. Cir. 1958); Ex-

change Act §15(b)(5). Such a finding is wholly lacking in this case. The sanctions were originally imposed by the Hearing Examiner because of the finding of manipulation. The full Commission sustained such sanctions while refusing to find that the reason for their imposition, manipulation, did in fact exist. Rather Petitioners were barred on the four relatively minor violations heretofore discussed, which are characterized as "extensive violations by registrant and Itin demonstrat[ing] gross indifference to the requirements of the securities laws and are inconsistent with their continued existence in the securities business."

Not one of the three violations imposed against Itin carried any implications of bad faith or wrongful intent. The fourth violation which was against Armstrong, Jones only, i.e., wrongful price predictions, was the result of the activities of one of the original respondents who is no longer participating in this proceeding. No reason is given for such harsh penalties in the face of innocent violations (if violations at all) and their imposition smacks of a sub rosa determination of manipulation, not founded on the record. This is the clearest kind of abuse of discretion.

These bizarre sanctions are all the more arbitrary because several of the original respondents were either completely "acquitted" of any wrongdoing, or who were censored only. Three of the original respondents involved in the common control issue or the manipulation charge received no sanctions whatsoever and as to them the proceedings were dismissed. A fourth, who was held responsible for two interstate sales (while Petitioners were held to have been involved in only one) was merely censored for such participation.

When the sanctions are so out-of-line both with regard to the violations involved, and with those sanctions imposed on the other involved respondents, the reviewing court cannot simplisticly say that no abuse of discretion is evidenced.

WHEREFORE, upon the foregoing grounds, it is respectfully urged that this writ of certiorari be granted and that the order of the Court of Appeals be reversed.

Dated, New York, N. Y.
April 21, 1970.

Respectfully submitted,

JAMES C. SARGENT
Counsel for Petitioners

JOHN M. HADLOCK
Of Counsel

APPENDICES

APPENDICES

APPENDIX A-1

Opinion of the Court of Appeals

No. 19291

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

ARMSTRONG, JONES & Co., and THOMAS W. ITIN,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION to Review an Order of the Securities and Exchange Commission.

Decided January 23, 1970.

Before: PECK and COMBS, Circuit Judges, and BROWN*, District Judge.

PECK, Circuit Judge. This case is before the Court on a petition for Review of the Findings and Order of the Securities and Exchange Commission (hereinafter "Commission"). The Commission found that petitioners, Armstrong, Jones & Co. and its president and chairman, Thomas W. Itin, violated various sections of the Securities Act of 1933

* Honorable Bailey Brown, Chief Judge, United States District Court for the Western District of Tennessee, sitting by designation.

and the Securities Exchange Act of 1934 and the rules promulgated thereunder. Based upon its finding of violations the Commission ordered the permanent revocation of Armstrong Jones's broker-dealer registration and further ordered Armstrong Jones expelled from the National Association of Securities Dealers. The Commission also ordered that petitioner Itin be barred from association with any broker-dealer with the exception that he could become so associated after one year, subject to a showing of adequate training and supervision.

The Commission found four major violations of the securities laws.[1] The primary issue with respect to each violation is whether there is substantial evidence in the record as a whole to support the Commission's finding. The petitioners also raise issues concerning the appropriateness of the sanctions imposed by the Commission and the alleged denial of certain procedural rights at the hearing. We will deal briefly with each of these issues.

The first violation found was of the securities registration provisions of the Securities Act of 1933. Sections 5(a) and 5(c) of that Act (15 U.S.C. §§ 77e(a), 77e(c)) provide, in substance, that it is unlawful to sell or offer to sell any security unless a registration statement for that security has been filed with the Commission and such registration statement has become effective. However, if the security is part of an issue offered and sold only to residents of a single state, the security is exempt from the registration provisions. 15 U.S.C. § 77c(a)(11). If any of the securities of the issue are sold to or offered for sale to nonresidents of the state, the exemption is lost for the entire issue. Securities Act Release No. 4434 (1961).

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[1] The Findings and Opinion of the Commission is reported in Securities Exchange Act Release No. 8420 (1968).

The Commission found that the petitioners knowingly sold stock of the Alexander Hamilton Life Insurance Company, a Michigan corporation for which they had claimed an intrastate exemption from registration, to nonresidents of Michigan. The Commission based its ultimate finding of a violation on its finding that petitioners either knew or should have known that some of the actual purchasers of the initial offering of the stock were nonresidents of Michigan, and its finding that Itin had actively sought orders for the stock, to be executed immediately after the commencement of trading of the stock, from nonresidents of Michigan. The Commission concluded that petitioners knew or should have known that the exemption from registration for entirely intrastate sales of stock was not applicable to the offering of the Hamilton Life stock, and that therefore the petitioners wilfully violated the securities registration provisions of the Act. Our review of the entire record discloses substantial evidence to support the Commission's findings, and we must therefore affirm the Commission's finding of this violation.

The next violation found by the Commission was of section 17(a) of the Securities Act and sections 10(b) and 15(c)(1) of the Securities Exchange Act (15 U.S.C. §§ 78q (a), 78j(b) and 78o(c)(1), respectively). The Commission found that the sales manager and various salesmen of Armstrong Jones made predictions about the likelihood of appreciation in value of the Hamilton Life stock without an adequate basis for such predictions, and that they used such predictions to induce customers to purchase the stock, all in violation of the above statutory sections which prohibit the use of fraudulent statements in connection with the sale of any stock.

Only petitioner Armstrong Jones is charged with this violation, and it apparently does not seriously dispute that unwarranted and inaccurate price predictions were made. It does contend, however, that the company cannot be found to have wilfully violated the fraudulent representation provisions because of the unauthorized acts of its agents. Petitioner contends that the attribution to it of the employees' wrongful conduct is in essence a finding that it failed to adequately supervise their activity, a separate ground for remedial action under section 15(b)(5)(E) of the Securities Act. We must disagree. It has long been the position of the Commission that a broker-dealer may be sanctioned for the wilful violations of its agents under the doctrine of *respondeat superior*. *See Cady, Roberts & Co.*, 40 S.E.C. 907, 911 (1961); *H. F. Schroeder & Co.*, 27 S.E.C. 833, 837 (1948). The fact that Congress enacted an additional provision giving the Commission the power to impose a sanction on a broker-dealer for failure to adequately supervise its employees does not limit the Commission's power to discipline a broker-dealer for its employees' acts. Having thus determined that the Commission may properly sanction a broker-dealer for the wilful acts of its agents, and having found substantial evidence in the record as a whole to support the Commission's findings that the Armstrong Jones agents wilfully violated the fraudulent representation provisions of the securities laws, we must affirm the Commission's finding of this violation.

The next violation found by the Commission was that Armstrong Jones, wilfully aided and abetted by Itin, wilfully failed to disclose to the purchasers of the Hamilton Life stock that the Alexander Hamilton Life Insurance Company and Armstrong Jones were under common control. Section 15(c)(1) of the Securities Exchange Act (15

U.S.C. § 78o(c)(1)) and Rule 15c1-5 thereunder require a broker-dealer which is "controlled by, controlling or under common control with, the issuer of any security" to disclose the fact of such common control to any purchaser of such security. Such disclosure may be written or oral, but if oral, written disclosure must also be made at or before the completion of the transaction.

Whether there is common control of a broker-dealer and an issuer of a security is a question of fact to be decided from all the circumstances of each case. Although there is no definition of "control" in the above cited statute or rule, another rule promulgated under the Securities Exchange Act, Rule 12(b)-2 defines control as:

> "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."

In other analogous circumstances the Commission has held that common control exists whenever "both corporations are controlled by individuals united by several factors tending to create and maintain community of interest among them." *J. P. Morgan & Co.*, 10 S.E.C. 119, 136 (1941).

Applying these principles to the evidence, the Commission found that Armstrong Jones failed to disclose that three individuals, the chairman of the board of directors, and two other directors and officers of Hamilton Life, controlled, together with Itin, Armstrong Jones. Upon review of the entire record, we find substantial evidence to support this factual finding of common control. There remains, however, the question of whether there was a sufficient disclosure of such common control. Petitioners raise sev-

eral arguments that there was sufficient disclosure of any common control relationship in their various applications to the Securities Commission of the State of Michigan and to the Detroit Stock Exchange. Petitioners also contend that there was a sufficient disclosure by a reference in a Hamilton Life prospectus that Itin was a stockholder of Hamilton Life. Finally, petitioners assert that there was no duty to disclose because any common control relationship which existed was not material. The short answer to these arguments is that there is no requirement in Rule 15c1-5 that any common control relationship be material, nor is there any provision in the Rule that any disclosure which may have been effected by the petitioners' applications to the Michigan Securities Commission or the Detroit Stock Exchange would relieve the petitioners of the duty under the Rule to give written disclosure of such relationship at or before the consummation of the sale. It is clear that the purpose of the Rule is to insure that customers know of any common control relationship which might affect the broker-dealer's objectivity about the stock. The purpose of the Rule is not served by saying that customers could determine that such a common control relationship existed by making a diligent search of certain public records. The Rule requires the broker-dealer to give written notice *to the customer*. There was no evidence that petitioners gave their customers written notice of common control during the relevant period of time in which the Commission found the common control relationship existed. We must therefore affirm the Commission's finding of this violation.

The final violation found by the Commission was of section 17(a) of the Securities Act and sections 10(b) and 15(c)(1) of the Security Exchange Act (15 U.S.C. §§ 78q

(a), 78j(b) and 78o(c)(1), respectively), the record keeping and anti-fraud provisions of the securities laws. The finding of the violation grew out of Armstrong Jones's actions as an underwriter for an offering of stock of Windsor Raceway Holdings Limited (hereinafter "Windsor"). While waiting for the registration statement for the Windsor stock to become effective, Armstrong Jones's salesmen sought indications of interest from potential customers for the Windsor stock, actual sales of the stock being prohibited by section 5(a) of the Securities Act until the registration statement became effective. The effective date of the registration statement for the Windsor stock was delayed beyond the date originally anticipated, and when the registration statement finally did become effective it appeared to petitioners that many of the potential customers for the Windsor stock had lost interest. On the day the registration statement became effective petitioners instructed its salesmen to contact the persons who had given indications of interest to determine whether they still desired to purchase the Windsor stock. However, with knowledge that some of the salesmen had as many as 100 persons to contact, the petitioners directed that confirmations of purchase be sent that same day to all persons who had given indications of interest. The confirmations of sale to many persons were followed up by telegrams stating that unless payment for the stock was immediately forthcoming, the stock would be sold at the market price and the purchaser would be liable to Armstrong Jones for any difference between the purchase price and the market price.

The Commission determined that the indications of interest were not sufficient, without more, to bind the prospective purchasers of the Windsor stock, and that the sending of the confirmations of sale and telegrams without first get-

ting a firm agreement to buy the Windsor stock from the prospective customers was fraudulent and a violation of the above cited statutes and the rules thereunder.

Petitioners do not dispute that such confirmations of sale and telegrams were sent to the persons who had given indications of interest, but they do argue that no further agreement to buy the stock was necessary, the indications of interest being a binding commitment to purchase the stock. The Commission, on the other hand, argues that indications of interest are no more than their name implies, and that they must be transformed into a clear agreement to purchase the stock before a sale is consummated.

There appear to be no cases directed at the narrow issue of whether an indication of interest must be "firmed up" by determining whether the prospective customer still desires to purchase the stock before sending a confirmation of sale, but past Commission decisions on other issues have been based on the premise that an indication of interest must be transformed into a firm agreement to buy before there is an effective sale of the security. For example, in *Matter of Otis & Co.*, 35 S.E.C. 650 (1954), the Commission held that a broker-dealer has not sold a security prior to the effective date of the registration statement for the security merely by soliciting indications of interest followed by confirmations of sale immediately upon learning that the registration statement had gone into effect. The rationale of the Commission's decision appears to be that indications of interest, standing alone, are not sufficient to constitute binding commitments to purchase the stock. *Matter of Otis & Co., supra,* at 659-60; *see also P. J. Gruber & Co.*, 38 S.E.C. 171 (1958); I L. Loss, Securities Regulation 215, 224 (2d ed. 1961). The petitioners countered with evidence that the gen-

eral practice of Detroit securities dealers was to send confirmations of sale to all persons who had given indications of interest without first checking with those persons to determine if they still wanted to buy the stock.

However, we need not decide in this case whether, as a matter of law, an indication of interest is the equivalent of a binding commitment to purchase stock or whether an indication of interest must be "firmed up" prior to sending a confirmation of sale. The Commission's finding of a violation in this case was based on a finding that many of the persons who had given indications of interest and to whom confirmations of sale were sent did not in fact agree to purchase the Windsor stock. The Commission found that the indications of interest turned out to in fact indicate widely varying degrees of interest in the Windsor stock. Some of those contacted were actually interested in the stock, some had a slight interest in the stock but did not actually order any stock, and some had no interest in the stock but did not object to a salesman's suggestion that some stock be "set aside" for them. The Commission found it to be clear that many of the persons solicited by Armstrong Jones did not understand that by expressing some interest in the Windsor stock they were thereby committed to the purchase of that stock. Upon review of the entire record we find substantial evidence to support the Commission's findings, and we therefore affirm the Commission's finding of this violation.

We will now deal briefly with the other two issues raised by the petitioners. The first is whether they were denied the right to a fair hearing by reason of the fact that they were denied, prior to the hearing, access to the names and prehearing statements of prospective witnesses against them. Whatever the desirability of such discovery procedures may be, there is no requirement that the Commission

furnish a list of all the prospective witnesses' names prior to the hearing. *See Dlugash* v. *SEC*, 373 F.2d 107, 110 (2d Cir. 1967). Even under the more stringent conditions which prevail in criminal proceedings under the Jencks Act (18 U.S.C. § 3500) it is only required that a witness' prehearing statement be made available following his direct examination. Thus while the Jencks Act is without present application, it is to be noted that the statements in question were submitted immediately after the testimony in chief of the witnesses in question was received. Furthermore, the Hearing Examiner advised counsel at the beginning of the hearing that they could apply for a continuance at any time they felt they needed more time to examine a witness' prehearing statement. Our examination of the record does not indicate that petitioners were prejudiced by the Commission's rulings with regard to the witnesses' names or statements. We therefore find no basis for the claimed denial of a fair hearing.

The final issue raised by the petitioners concerns the appropriateness of the sanctions imposed by the Commission. Petitioner Itin in particular contends that the sanctions imposed on him were too harsh in light of his inexperience, his reliance on the advice of counsel and the loss of income and damage to his reputation which he has already incurred. However, the rule is clear that the determination of the sanctions necessary to protect the public interest rests primarily in the discretion of the Commission. Unless a gross abuse of discretion on the part of the Commission is shown, the Commission's determination of the sanctions necessary to protect the public interest will not be disturbed. *See Lawrence* v. *SEC*, 398 F.2d 276, 280 (2d Cir. 1968); *Marketlines, Inc.* v. *SEC*, 384 F.2d 264, 267 (2d Cir. 1967), *cert. denied*,

390 U.S. 947 (1968); *Tager* v. *SEC*, 344 F.2d 5, 8-9 (2d Cir. 1965). While we might have imposed different sanctions had the initial determination in that regard been ours, our review of the record discloses no abuse of discretion on the part of the Commission, and its determination will therefore not be disturbed.

The Commission's order will be affirmed.

APPENDIX A-2

Order of the Court of Appeals

No. 19,291

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

ARMSTRONG, JONES & Co., and THOMAS W. ITIN

Petitioners

v.

SECURITIES and EXCHANGE COMMISSION

Respondent

ORDER

Before: PECK and COMBS, Circuit Judges, and BROWN,* District Judge.

It is HEREBY ORDERED that the opinion heretofore filed in this cause, be, for the purpose of correction of certain errors appearing in the slip opinion, but, in no way affecting the holding or substance of the opinion, amended as follows:

Page 3, second full paragraph, third sentence, strike the words "Securities Act" and substitute therefore "Securities Exchange Act."

* Honorable Bailey Brown, Chief Judge of the United States District Court for the Western District of Tennessee, sitting by designation.

Page 6, first full paragraph, first sentence, after the word "sections" add "17(a)", and after the words "(15 U.S.C. §§" add "77q(a)".

Page 9, eight lines from the bottom, in the citation of *Lawrence* v. *SEC*, 398 F.2d 276, strike the words "2d Cir." and substitute therefore "1st Cir."

ENTERED BY ORDER OF THE COURT

/s/ CARL W. REUSS
Clerk

APPENDIX A-3

Findings and Opinion of the Commission, Dated October 3, 1968

(Securities Exchange Act Release No. 8420)

ADMINISTRATIVE PROCEEDING
FILE No. 3-336

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
October 3, 1968

[SAME TITLE]

BROKER-DEALER PROCEEDINGS

Offer, Sale and Delivery of Unregistered Securities
Fraudulent Representations in Offer and Sale of Securities
Failure to Disclose Common Control
Confirmations of Unauthorized Transactions
False and Fictitious Records

Where registered broker-dealer offered, sold and delivered unregistered securities, made fraudulent price predictions to customers, failed to disclose to customers that registrant and issuer of securities were under common control, sent confirmations of sales to persons who had indicated interest in but had not offered to buy securities, and made false and fictitious records and entries, *held,* willful violations of registration provisions of Securities Act of 1933, anti-fraud provisions of that Act and Securities Exchange Act of 1934, and record-keeping provisions of latter Act, and in public interest to revoke broker-dealer's registration and expel it from membership in registered securities association and national securities exchange.

Where residents of same state as issuer, which offered and sold unregistered securities pursuant to claimed intrastate exemption under Section 3(a)(11) of Securities Act of 1933, variously acted as nominees of or alleged trustee for non-residents or resold securities to non-residents under circumstances indicating that offering had not come to rest exclusively in hands of residents, *held*, exemption unavailable for entire offering, including portion sold to residents.

Practice and Procedure

Contentions by respondents that Commission's staff had induced customers to give biased statements during investigation, that such statements were used to refresh their recollection before taking stand without giving respondents opportunity to examine statements until conclusion of direct examination, that respondents' request for list of staff's proposed witnesses was improperly denied, and that staff improperly failed to interview various employees and former officer of registrant, or to name officer as respondent or call him as a witness, *rejected*.

Appearances:

WILLIAM D. GOLDSBERRY and MARK A. LOUSH, of the Detroit Branch Office of the Commission, and DONALD W. MCKENZIE, of the Chicago Regional Office of the Commission, for the Division of Trading and Markets.

JAMES C. SARGENT and MICHAEL HEITNER, of Lowenstein, Pitcher, Hotchkiss & Parr, for Armstrong, Jones and Company and Thomas W. Itin.

JAMES F. LITTELL and DAVID ROBB, of Poole, Warren & Littell, for George A. Reuter.

HARRY A. CARSON and THOMAS A. ROACH, of McClintock, Fulton, Donovan & Waterman, for Rene F. Campeau.

W. MCNEIL KENNEDY, HERBERT S. WANDER, and MICHAEL WARNER, of Pope, Ballard, Uriell, Kennedy, Shepard and Fowle, and JOHN L. VANKER, of Butzel, Eaman, Long, Gust & Kennedy, for E. Keith Owens, Charles H. Bruce, and Robert O. Safford.

Following extensive hearings in these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that the registration as a broker and dealer of Armstrong, Jones and Company ("registrant") should be revoked and that it should be expelled from membership in the National Association of Securities Dealers, Inc. ("NASD") and the Detroit Stock Exchange, and that certain sanctions should be imposed upon Thomas W. Itin, registrant's president, Rene F. Campeau, executive vice-president and sales manager, George A. Reuter, vice-president in charge of trading, E. Keith Owens, one of registrant's principal stockholders, and Charles H. Bruce and Robert O. Safford, directors of registrant. We granted petitions of respondents for review of the initial decision as to certain issues and on our own motion ordered review of the initial decision with respect to all issues involved in the proceedings. Briefs were filed by respondents and our Division of Trading and Markets ("Division"), and we heard oral argument. Our findings are based upon an independent review of the record.

I.

Alexander Hamilton Life Insurance Company ("Hamilton Life"), which was incorporated in Michigan in October 1963, commenced a public offering about November 15, 1963, of 1,500,000 shares of Class A common stock at $4 per share pursuant to a claimed intrastate exemption under Section 3(a)(11) of the Securities Act of 1933 from the registration provisions of that Act.[1]

The underwriter was a firm organized by Owens for the purpose of underwriting the offering and was wholly owned by him, and the selling group consisted of registrant and another securities firm. The offering was terminated on March 23, 1964.[2] Registrant commenced trading in Hamilton Life stock in the over-the-counter market on April 27, 1964.

Violation of Registration Provisions

The prospectus used in the offering of Hamilton Life stock stated that the offering was limited to residents of Michigan, and each purchaser was required to sign a subscription agreement certifying that he was such a resident

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[1] Section 3(a)(11) of the Securities Act exempts from registration "any security which is part of an issue offered and sold only to persons resident within a single State . . . , where the issuer of such security . . . , if a corporation, [is] incorporated by and doing business within, such State. . . ."

[2] The offering was initially oversubscribed by 682,000 shares. Pursuant to a plan formulated with the state securities authorities to avoid violations of state law, subscribers for the original 1,500,000 shares were allowed to rescind and the remaining subscribers were told that their subscriptions had been rejected but that they could resubscribe. After rescissions and resubscriptions approximately 24,000 shares remained unsold and such shares were purchased by registrant and associated persons of Hamilton Life between April 3 and 15, 1964.

and was purchasing the stock for his own account for investment. However, two persons who signed such agreements were in fact nominees for non-resident purchasers of a total of 1,550 shares, and Owens subscribed to 375 shares allegedly as trustee for a non-resident.

In one instance, three non-residents, including an acquaintance of Itin, arranged for a resident-nominee, the uncle of one of the non-residents, to purchase 1,000 shares in their behalf. About March 15, 1964, the nominee sent to registrant a subscription agreement together with a $4,000 treasurer's check payable to registrant, which had been purchased by the non-resident nephew from a savings and loan association in his state. Itin at first testified that the nominee told him he had purchased the check from "his" savings association, but later admitted that he knew the check came from the nominee's nephew. Itin also knew the nephew was a non-resident. Itin advised the nominee that the check should have been made payable to the escrow agent, and on March 17, he endorsed the treasurer's check in registrant's behalf and returned it together with the subscription agreement to the nominee who in turn sent them to his nephew. On March 23, the last day of the offering, Itin informed the nominee that payment was due that day if he still wished to purchase the stock. The nominee stated that he did not have sufficient funds in his checking account but would ask his nephew to send the money directly to Itin. The nephew called Itin later that day and Itin told him that since payment could not possibly be received that day, he would advance the money, and on the following day the nephew sent to Itin a new check and a second subscription agreement purporting to be signed by the nominee.[8] We agree with the examiner's

[8] The nephew testified that his uncle, the nominee, had signed the second subscription agreement and given it to him on March 21, whereas the nominee testified that the signature was not his.

finding that the circumstances surrounding this sale were sufficient to put Itin on notice that the purported purchaser was acting on behalf of a non-resident. Particularly suspect were the facts that the treasurer's check, as Itin knew, was sent by a non-resident, and that the second subscription form and check also came from him.

The second instance involved a non-resident from an adjoining state whom Owens had known for many years, having lived in the same town. Following a call from and apparently at the suggestion of that non-resident, Owens, acting on behalf of the underwriter, sent a prospectus and subscription form to a resident who had indicated to the non-resident an interest in Hamilton Life. Shortly thereafter the resident requested and received four additional subscription forms from Owens. The resident signed and returned each of the forms for varying amounts of stock totalling 750 shares and indicated that the certificates were to be issued in his name. Accompanying the executed forms were five checks in payment for the varying amounts of stock. Four of the checks were drawn on the same bank, dated the same day, and consecutively numbered. These subscriptions in fact represented the purchase of 200 shares by the resident and of the remaining 500 shares by four non-residents, including the acquaintance of Owens.[4] We think that the facts that this transaction was initiated by a non-resident, that an individual, who was supposedly buying stock for his own account, submitted five subscription forms for varying amounts of stock with a separate check covering each amount, and that four of the checks were drawn on one bank should have alerted Owns to inquire into the transaction with a view

[4] A certificate for 750 shares was subsequently sent to the resident who then arranged to have new certificates issued in the names of the five purchasers.

to determining whether the resident was purchasing stock either for non-residents or for other residents who were not buying for investment.[5]

The third out-of-state sale occurred when Owens, allegedly acting as a trustee for a non-resident, subscribed to 375 shares for which he paid with funds which had been sent to him by the non-resident to invest at his discretion. At Owens' direction, a certificate for 250 shares was issued to him and the non-resident as tenants in common, and a certificate for the remaining shares was issued to them as joint tenants.[6] Whether or not Owens was a trustee, we are of the opinion that he was acting primarily as an agent or broker and did not intend to do anything more than select investments for his principal. There is a substantial question whether he was a trustee in the sense urged. The checks sent to Owens by the non-resident were payable to Owens in his individual capacity, and not as "trustee." Owens did not subscribe to the shares as "trustee" but rather certified that he was purchasing for investment for his own account, and he subsequently directed that the certificates be issued in both his own name and that of the non-resident. He testified that he had the certificates placed in both names so that if anything happened to him there would be "some indication" that the stock "belonged" to the non-resident. There is no evidence that the non-resident and Owens intended to establish a trust estate which could be considered a source of local funds and con-

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[5] See *Strathmore Securities, Inc.*, Securities Exchange Act Release No. 8207, pp. 9-11 (December 13, 1967), for a discussion of the responsibility of securities salesmen to make certain basic inquiries when circumstances raise questions as to the legality of proposed transactions with customers.

[6] In May 1965, the shares were transferred to the non-resident alone.

tribute to the local "financing" contemplated by the intrastate exemption.[7]

The record further establishes, contrary to the hearing examiner's conclusion, that an out-of-state distribution occurred when a part of the original offering was resold by resident subscribers shortly after registrant's commencement of trading in the stock on April 27, 1964. Although, except for the three instances described above, precautions were taken to confine the offering to residents who certified that their purchases were for investment, and interested non-residents were informed prior to the commencement of trading that they could not buy the stock at that time, Itin contributed to or even encouraged the resale of stock held by residents to non-residents shortly after trading began. Between February and April 1964, during the period of the offering and prior to the commencement of trading, Itin recommended to or solicited the purchase of such stock by two non-residents, and advised three others to place orders or indications of interest as soon as possible to assure the best execution upon the commencement of trading. Altogether, registrant received orders or indications of interest from about 35 to 40 non-residents for about 20,000 shares before April 27, 1964.[8]

Registrant's opening bid on that date was 7, which tended to induce residents, who had presumably purchased for investment, to sell their stock for a quick and substantial profit and enable registrant to resell the stock to non-residents who had given it orders or indications of interest. Registrant sold at least 11,500 shares betweeen April 27 and May 1, 1964 to 29 non-residents, including 2 broker-dealers, at prices ranging from 7¾ to 9½, at least 10,000

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[7] See Securities Act Release No. 4434 (December 6, 1961).

[8] The record discloses as to ten of the non-residents that three placed orders at market, and seven placed limit orders: one at 4½, three at 5, one at 5½ and two at 8.

shares between May 4 and 30 to 36 non-residents, including 2 broker-dealers, at from 8¼ to 14, and at least 13,400 shares between June 2 and August 31, 1964, to 71 non-residents, including 15 broker-dealers, at from 11½ to 19¾.[9]

It is clear that a securities issue has not come to rest with residents where orders and indications of interest have been solicited from non-residents during the offering of the securities, and trading begins at a substantial increase over the offering price.[10] "It is incumbent upon the . . . underwriter, dealers and other persons connected with the offering to make sure that it does not become an interstate distribution through resales."[11] We find that registrant and Itin failed to discharge this responsibility since the record establishes that they intended to sell Hamilton Life stock to non-residents as soon as the market opened.

In view of the offers and sales of Hamilton Life stock to non-residents, no intrastate exemption was available and

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[9] The record does not indicate the nature or volume of registrant's transactions in Hamilton Life stock after August 31, 1964.

[10] Resales by residents shortly after the commencement of trading are evidence that they did not purchase for investment. *Cf. Skiatron Electronics and Television Corporation*, 40 S.E.C. 236, 249 (1960); Securities Act Release No. 4434 (December 6, 1961). We reject respondents' contention that the facts that all the subscribers to the offering did not rescind their orders or resubscribe and that the remaining shares were purchased by registrant and persons associated with Hamilton Life, demonstrated that the residents had acquired the stock for investment and the offering had come to rest. Refusal of the offer to rescind or resubscribe was not inconsistent with an intention to resell within a short time if a profit could be realized.

[11] Securities Act Release No. 4434 (December 6, 1961). See also *Capital Funds, Inc.*, Securities Exchange Act Release No. 7398, p. 4 (August 20, 1964), *aff'd* 348 F. 2d 582 (C.A. 8, 1965).

therefore registrant, Itin, and Owens violated Sections 5(a) and 5(c) of the Securities Act in the offer, sale, and delivery of such stock.[12] Such exemption is not available unless the entire issue is offered and sold to, and comes to rest exclusively in the hands of, residents.[13] "If any part of the issue is offered or sold to a non-resident, the exemption is unavailable not only for the securities so sold, but for all seurities forming a part of the issue, including those sold to residents."[14]

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[12] We reject respondents' contention that the application of the securities laws in these proceedings is an unlawful intrusion upon the power to regulate "the business of insurance" expressly reserved to the States by Congress in the McCarran Act (15 U.S.C. 1011-15). Their reliance upon *S.E.C.* v. *National Securities, Inc.*, 387 F. 2d 25 (C.A. 9, 1967), *cert. granted*, is misplaced. That case held that invalidation of a state-approved merger of life insurance companies, on the ground that the proxy soliciting material used to secure shareholder approval violated anti-fraud provisions of the Exchange Act, would "impair" the state statutory procedures for such mergers. The offer and sale of insurance company stock, however, cannot be equated to the insurance business and is not covered by the McCarran Act. See *U.S.* v. *Meade*, 179 F. Supp. 868 (S.D. Ind., 1960); *S.E.C.* v. *American Founders Life Insurance Company of Denver, Colorado*, Civ. Action No. 6021 (D. Colo., May 7, 1958), where the order stated: "The offer for sale, sale and delivery of capital stock of insurance companies is not 'the business of insurance' within the contemplation of . . . [the McCarran Act], and thus . . . is not exempt from the operation of the Securities Act. . . ."

[13] A distribution of securities comprises "the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hand of the investing public." *Lewisohn Copper Company*, 38 S.E.C. 226, 234 (1958).

[14] Securities Act Release No. 4434 (December 6, 1961). See also *Capital Funds, Inc.* v. *S.E.C.*, 348 F. 2d 582, 586 (C.A. 8, 1965), *aff'g Capital Funds, Inc.*, Securities Exchange Act Release No. 7398 (August 20, 1964); *S.E.C.* v. *Hillsborough Investment*

We further conclude that such violations were willful. As we have seen, these respondents knew or should have known that no exemption under Section 3(a)(11) was available.[15]

Violations of Anti-Fraud Provisions

1. *Fraudulent Representations*

In the offer and sale of Hamilton Life stock, Campeau and various salesmen of registrant made extravagant and unwarranted representations and price predictions to customers. Campeau told a customer, who purchased 500

Corp., 276 F. 2d 665 (C.A. 1, 1960); *Ned J. Bowman Company*, 39 S.E.C. 879, 881 (1960).

Respondents assert that our staff advised registrant, in so-called "no-action" letters, that an intrastate exemption would be available for the proposed offering, and did not warn registrant that any sale to a non-resident would defeat such exemption nor mention resales to non-residents. However, those letters were based on the representation that the shares were proposed to be offered to residents, stated that the offering "may be" exempt if "limited to bona fide residents" who "acquire their shares for investment and not for resale to non-residents," and enclosed a copy of Securities Act Release No. 4434 which, as previously indicated, expressly states that if any part of the issue is offered or sold "directly to non-residents or indirectly through residents who as part of the distribution thereafter sell to non-residents," the exemption for the whole issue is defeated.

[15] *Cf. Aircraft Dynamics International Corp.*, 41 S.E.C. 566, 573 (1963); *Morris J. Reiter*, 41 S.E.C. 137, 141 (1962).

The record further shows, as charged in the order for proceedings, that registrant bid for and purchased Hamilton stock during the distribution of the offering. Such bids and purchases are proscribed by Rule 10b-6 under Section 10(b) of the Exchange Act. However, the hearing examiner dismissed the charge of violation of these provisions because the Division failed to pursue it and we have determined not to consider such violation in assessing the sanctions to be imposed.

shares at 7½ and 7¾ on April 27, 1964, before the company had sold any insurance, that he thought the stock had "extreme growth possibilities" and "could possibly hit 30" in four or five years, and advised another customer, who purchased 400 shares at 16½ on June 9 and 100 shares at 13⅝ on July 1, that the price would be 50 in 18 months. Two salesmen respectively represented to two customers who purchased a total of 310 shares in June 1964 at 12, 16¼ and 19, that the price could rise to "around" 30 within a year or two, and that the stock was "terrific" and he thought it would be selling at 23 or 25 in a short time. Another salesman told a customer, who purchased 100 shares at 19¼ on June 28, that there were "bets in the office" that the price would go to 27 by July 4. From May to July 1964, five other salesmen, in connection with sales of a total of 829 shares to five customers at prices which in one instance was 9¼ and otherwise ranged from 13 to 20, variously predicted price increases to 30, 40 or 100 within a year, or 30 or 40 by the end of the year.

Respondents assert that the testimony of the customers with respect to the above representations was vague and was contradicted by the testimony of Campeau and five of the salesmen, was adduced through leading questions, and was influenced in some cases by the fact that the customers had lost money on their investment. Respondents contend that the alleged price predictions were not fraudulent because they were couched in terms of opinion and customers were informed that the stock was speculative, and because Hamilton Life assertedly was organized after extensive studies and planning, had skilled personnel, and sold an exceptional amount of insurance during its first few weeks of operation beginning in May 1964. Respondents further assert that registrant's salesmen did not use high-pressure sales techniques, that registrant was not a boiler-room since

most of the customer-witnesses had previous business or social relationships with registrant's salesmen, and that there is no evidence of other types of typical boiler-room misrepresentations or that the price predictions induced the purchases or were relied upon by the customer-witnesses, most of whom initiated the transactions.

The hearing examiner, who heard the witnesses and observed their demeanor, credited the customers' testimony, and we find no adequate basis in the record for disagreeing with his conclusions in that respect. Merely because a customer may have lost money is no reason for rejecting his testimony, especially where the representations attributed to the salesmen by a numbor of customers are similar.[16] Nor do we think that the examiner abused his discretion in permitting some leading questions by Division counsel.[17] The predictions of specific and substantial increases in the price of this speculative security were inherently fraudulent,[18] and it is irrelevant that such predictions were couched in terms of opinion and the customer was advised that the security was speculative,[19] or that the purchaser was a

[16] See *Irving Friedman,* Securities Exchange Act Release No. 8076, p. 7 (May 16, 1967); *R. Baruch and Company,* Securities Exchange Act Release No. 7932, p. 7 (August 9, 1966); *A. J. Caradean & Co., Inc.,* 41 S.E.C. 234, 238 (1962).

[17] See McCormick *Evidence* (1954), Section 6; II Wigmore, *Evidence* (3d ed. 1940), Section 770; *Robertson* v. *U.S.,* 249 F. 2d 737, 742 (C.A. 5, 1957), *cert. denied,* 356 U.S. 919; *Mitchell* v. *U.S.,* 213 F. 2d 951, 956 (C.A. 9, 1954), *cert. denied,* 348 U.S. 912.

[18] See *A. T. Brod & Company,* Securities Exchange Act Release No. 8060, p. 2, n. 3 (April 26, 1967); *R. Baruch and Company, supra,* at p. 6 of cited Release.

[19] *James De Mammos,* Securities Exchange Act Release No. 8090, p. 3 (June 2, 1967), *aff'd* C.A. 2, Docket No. 31469 (October 3, 1967); *R. Baruch and Company, supra; Alfred Miller,* Securities Exchange Act Release No. 8012, p. 5 (December 28, 1966), *aff'd* C.A. 2, Docket No. 31270 (January 4, 1968).

friend or former customer of the salesman[20] or initiated the transaction.

It is not necessary to establish that registrant's salesmen engaged in boiler-room or high-pressure tactics,[21] that the issuer had an adverse financial condition, that the price predictions induced the purchases and were relied upon by the customers,[22] or that other types of fraudulent representations were made.[23] Moreover, apart from the inherently fraudulent nature of the price predictions, Campeau and the salesmen had no reasonable basis for making them.[24] Although insurance sales by the company may have been above average in its first month or two of business in May and June 1964, in view of the fact that as noted in Hamilton Life's prospectus the sale of life insurance is highly competitive, it was uncertain whether such sales would continue or whether or when sales volume would be translated into an operating profit.[25]

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[20] See *Alfred Miller, supra; James De Mammos, supra; Arnold Securities Corp.*, Securities Exchange Act Release No. 7813, p. 4 (February 7, 1966).

[21] See *Charles P. Lawrence*, Securities Exchange Act Release No. 8213, p. 3 (December 19, 1967), *aff'd* — F. 2d — (C.A. 1, July 11, 1968).

[22] See *e.g., A. T. Brod & Company*, Securities Exchange Act Release No. 8060, p. 4 (April 26, 1967); *Hamilton Waters & Co., Inc.*, Securities Exchange Act Release No. 7725, p. 6 (October 18, 1965).

[23] See *Arnold Securities Corp.*, Securities Exchange Act Release No. 7813, p. 3 (February 7, 1966).

[24] See *Aircraft Dynamics International Corp.*, 41 S.E.C. 566, 570 (1963): "A salesman who expresses an opinion about future market prices . . . impliedly represents that he has an adequate basis for such opinion. Absent such basis he violated his duty to deal fairly with customers and his implied representation is fraudulent."

[25] During its first month of operations beginning about May 5, 1964, Hamilton Life wrote nearly $15,400,000 worth of insurance, and by the end of the year it had $60,331,500 of insurance in force. It sustained an operating loss of $81,531 in 1964.

We conclude that registrant, together with or willfully aided and abetted by Campeau, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder.

2. *Failure to Disclose Common Control*

The hearing examiner found that between November 1963 and August 1964, registrant, Itin, and various of registrant's salesmen sold Hamilton Life stock to customers without disclosing, as required by Rule 15c1-5 under the Exchange Act, that registrant and Hamilton Life were under "common control." We find that Owens, Bruce, and Safford, who concededly controlled Hamilton Life, also controlled registrant, at least until early 1964.

Owens, Bruce, Safford, and another individual were the promoters of Hamilton Life, and Owens became chairman of the board, Bruce became president and a director, and Safford became vice-president and a director. Itin, about July 1962, had agreed to become a regional sales agent for the company. Because of the delay in securing state authorization for the public stock offering by the company and for conducting business, the substantial expenditures by the promoters, and the office lease and maintenance obligations incurred by Itin for his contemplated sales agency, Owens, Bruce and Safford agreed to join Itin in purchasing a majority of registrant's outstanding stock and thereby provide him with a source of current income from registrant to induce him to remain with Hamilton Life. They were also interested in supplementing their own income through their interest in registrant and ultimately selling such interest and realizing a capital gain. Between 75% and 80% of registrant's outstanding stock was acquired in

August or September 1963, with Owens contributing $16,679, Bruce $6,885, Safford about $8,400, and Itin, according to his testimony, between $10,000 and $25,000. Itin became president and a director of registrant, and Bruce and Safford became directors on the seven-member board, which was reduced to five members on October 16, 1963, with Itin serving as chairman and he, Bruce, and Safford constituting a majority of the board. Owens had intended to become a director of registrant, but did not do so because of certain business or legal problems. However, he attended one or two of registrant's board meetings and he, as well as Bruce and Safford, received a confidential "Weekly Management Report" on registrant's operations, prepared by Itin, from January through at least July 1964.

Following Hamilton Life's incorporation in October 1963, Owens, Bruce, Safford, and Itin sought a replacement for Itin as president of registrant without success. In March 1964, Itin decided to give up the sales agency and remain with registrant, and Owens, Bruce, and Safford sold their stock interests in registrant to him. Itin gave each of them a personal 6% promissory note for the amount of his investment in registrant's stock, and it was agreed that registrant would pay monthly to each of them, including Itin, a sum equal to $100 plus 1% of their respective investments in registrant. Pursuant to this arrangement, a total of $5,950 was paid by registrant between March and September 1964 to a company whose stock was owned equally by the four individuals and which had been formed as a means of pooling consulting and finders' fees. Owens, Bruce, and Itin testified that these payments were, in part, compensation for consulting services.

We do not agree with respondents that Itin, who was not a member of the control group of Hamilton Life, alone controlled registrant. The record establishes that Owens,

Bruce, and Safford, in company with Itin and Reuter, who was also a member of registrant's board, controlled registrant, at least until they conveyed their stock interests in registrant to Itin in March 1964. In reaching this conclusion we have taken into account their business association with each other and with Itin before and after Hamilton Life was incorporated; their acquisition of the majority of registrant's outstanding stock; their participation in management decisions relating to Itin's compensation as president and to a possible replacement for him in that position, and in plans and activities affecting registrant; and the memberships of Bruce and Safford on the board of directors of registrant. Under the circumstances, it is unnecessary to decide whether common control continued after Itin's acquisition of the stock interests of Owens, Bruce, and Safford in registrant.

Respondents contend that, in any event, appropriate disclosure of control was made in that the confirmations of sales to customers stated that an officer of registrant was a director of Hamilton Life. The confirmations in the record which were used prior to April 27, 1964, when the trading began, did not contain any such disclosure, although that disclosure appears in subsequent confirmations. Even assuming, however, that such confirmations were used during the period when we have found there was common control, the disclosure was inaccurate since the fact was that two officers of Hamilton Life were directors of registrant, and it did not satisfy the requirement of Rule 15c1-5 that disclosure be made prior to the sale.[26]

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[26] See *Pennaluna & Company, Inc.*, Securities Exchange Act Release No. 8063, p. 13, n. 23 (April 27, 1967).

We conclude that registrant, willfully aided and abetted by Itin, willfully violated Section 15(c)(1) of the Exchange Act and Rule 15cl-5 thereunder.[27]

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[27] We do not agree with the hearing examiner's conclusion that all the respondents are chargeable with the violations we have found of the anti-fraud provisions and, except for Reuter, of the registration provisions, on the grounds that they acted in concert in carrying out a plan to launch Hamilton Life in the insurance business and to provide a market for its stock, and that the unwarranted price predictions, the failure to disclose the existence of common control over Hamilton Life and registrant, and the offer and sale of unregistered stock to finance Hamilton Life were an integral part of such plan. The record does not establish concerted action by all respondents to engage in the fraudulent activities we have found, or to distribute the offering to non-residents.

Nor are any of the respondents whom we have not found to have committed certain of the violations chargeable with such violations, as urged by the Division, on the ground they failed to exercise adequate supervision. Inadequate supervision was not alleged in the order for proceedings, and, in view of Section 15(b)(5)(E) of the Exchange Act added by the 1964 amendments, which made inadequate supervision an independent ground for the imposition of a sanction, a failure of supervision cannot be held to constitute violations of other provisions which are charged as grounds for remedial action. Cases holding otherwise, *e.g., Reynolds & Co.*, 39 S.E.C. 902, 917 (1960), preceded the 1964 amendments.

The hearing examiner also found manipulation of the market in Hamilton Life stock. Registrant dominated the wholesale and retail markets in the stock, which imposed a special obligation on it to avoid any market-making activities which would affect the market artificially within the meaning of the anti-fraud and the anti-manipulation sections of the Act and implementing rules. While registrant's market-making activities raise questions whether it fulfilled this obligation and whether its activities were not colored by a desire to stimulate retail demand by moving market prices upward, in view of our disposition of the other issues in this case, we do not find it necessary to deal further with this issue.

II.

Confirmation of Unauthorized Transactions
False and Fictitious Records

Between October 23, 1964, when a registration statement with respect to an offering of stock by Windsor Raceway Holdings Limited ("Windsor") was filed with us, and December 21, 1964, when the registration statement became effective, registrant, which was named as the underwriter, solicited indications of interest and offers to buy from customers.[28] Some of the persons solicited indicated their interest in purchasing stock and other made offers to buy. Upon the effective date, Itin instructed the salesmen to telephone all persons who had given "indications of interest" in order to "firm up" those indications. On that day and the next, registrant sent confirmations of sales to all persons who had given indications of interest or made offers to buy in alphabetical order, except those who the salesmen advised registrant did not wish to purchase.[29] Accordingly confirmations were sent to a number of persons who had given indications of interest buy had not

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[28] Section 5 of the Securities Act permits offers to sell but not sales of a security during the pre-effective waiting period. Section 2(3) of that Act defines "offer to sell" to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security." The solicitation of an "indication of interest" is in effect an "offer to sell" within the meaning of Section 2(3), but not in the common law sense, and a mere indication of interest does not amount to an offer to buy. Such indications must be "firmed up" after the registration statement becomes effective, which is commonly done by making a common law offer to sell and securing the customer's acceptance. See 1 Loss, *Securities Regulation* (1961 ed.) p. 224.

[29] Two persons who had informed their salesman that they did not wish to purchase the stock testified that they nevertheless received confirmations.

been reached by the salesmen.[30] When payments were not forthcoming from persons who had received confirmations registrant, on January 19, 1965, sent telegrams to many of them, including persons who had not agreed to purchase, stating that unless payment was received by the following day the stock would be sold for the customers' account and the customer would be liable for any resulting loss to registrant.[31]

Registrant and Itin contend that the testimony of the customer-witnesses in these respects should not be accepted because it was inconsistent, and in many cases influenced by the customers' irritation at receiving the telegrams mentioned above. However, we find no adequate basis in the record for disagreeing with the hearing examiner's decision to credit that testimony; moreover, such testimony was in part corroborated by a saleswoman.[32]

Itin should not have caused registrant to send confirmations in alphabetical order to all persons other than those who had told the salesmen they did not wish to purchase. He must have realized that the salesmen could not possibly reach all persons who had submitted indications of interest before the confirmations were sent to them, especially since some of the salesmen had more than 100 persons to call.

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[30] One of the persons had not affirmatively indicated any interest and another had stated he had no interest. Both merely had acquiesced in the salesman's suggestion that he "set aside" stock for them with "no obligation."

[31] Registrant had accepted cancellations through January 8, 1965, from persons who received confirmations.

[32] A saleswoman for registrant testified that she had obtained "indications of interest" from about 150 customers, but realizing that she would be unable to reach all of them in a single day, made no attempt to reach those who she believed "would not cancel." Altogether, she spoke to 25 or 30 customers on December 21 and to about 85 customers thereafter.

Those confirmations and telegrams that were sent to persons who had not agreed to purchase the stock were false in representing that a sale had taken place. In that respect, registrant, together with or willfully aided and abetted by Itin, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15cl-2 thereunder.[33] The use of such confirmations and telegrams and the entering of "sales" and cancellations of such "sales" for non-payment upon the records of registrant also constituted the making of false and fictitious records and entries. In those respects, registrant, willfully aided and abetted by Itin, willfully violated the record-keeping provisions of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.[34]

III.

Other Matters

Respondents contend that the conduct of the investigation and hearings deprived them of due process. They assert that the Division induced customers to give biased statements during the investigation which were used to refresh the customers' recollection before they were called to testify and respondents were denied an opportunity to examine the staements until after the Division's direct examination of the customers. Respondents further com-

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[33] See *R. A. Holman & Co., Inc.* v. *S.E.C.*, 366 F. 2d 446, 451 (C.A. 2, 1966), *aff'g R. A. Holman & Co., Inc.*, Securities Exchange Act Release No. 7770, p. 10 (December 15, 1965); *Shelley, Roberts & Company of California*, 38 S.E.C. 744, 751 (1958).

[34] See *P. J. Gruber & Co., Inc.*, 38 S.E.C. 171, 173 (1958); *Shelley, Roberts & Company of California, supra.*

plain because their requests for a list of Division witnesses before the commencement of hearings were denied. In addition, registrant and Itin contend that the Division investigators improperly failed to interview salesmen of registrant with respect to statements obtained from their customers, and "turned their backs on witnesses and material" which might be favorable to these respondents or to name as a respondent, interview or call as a witness a former senior vice president of registrant who had been syndicate manager of the Windsor offering and was assertedly the "only" person in the firm with first-hand knowledge of all the facts relating to such offering.

There is no substance to these contentions; and in any event, no prejudice was shown. The record does not indicate any impropriety by the Division in obtaining statements from customers, and those statements were properly used to refresh their recollection.[35] Production of such statements for use in impeaching the witnesses was not required until after direct examination.[36] Nor was the Division required to furnish respondents with a list of its proposed witnesses.[37] In fact, the Division offered to furnish to counsel for each of the respondents the names of its witnesses scheduled to be called the following day, as well as the pre-hearing statements made by them, on condition that the contents of such statements and the names of the witnesses not be disclosed to counsel for the other respondents or discussed with the witnesses before

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[35] See III Wigmore, *Evidence* (3rd ed. 1940), Sections 758-62; McCormick, *Evidence* (1954), Section 9; *David T. Fleischman*, Securities Exchange Act Release No. 8187, p. 3 (November 1, 1967).

[36] *Ibid.* See Rule 11.1 of our Rules of Practice.

[37] *Dlugash* v. *S.E.C.*, 373 F. 2d 107, 110 (C.A. 2, 1967), *aff'g F. S. Johns & Co., Inc.*, Securities Exchange Act Release No. 7972, pp. 15-16 (October 10, 1966).

they testified. Only counsel for Campeau agreed to this condition. Moreover, it does not appear that upon the production of prior statements, counsel for respondents were denied sufficient time to review the statements before commencing cross-examination.

The Division in collecting and presenting evidence and recommending the institution of proceedings has considerable discretion in determining which persons to interview and call as witnesses and which in its opinion should be named as parties, and registrant and Itin were of course free to call any person as a witness if they wished to do so. We see no basis for assuming that the Windsor syndicate manager, because of alleged personal differences with Itin, would not have responded to questions by registrant's counsel with the same candor as he would have to questions by Division counsel. And if, as registrant and Itin assert, his testimony were essential to their defense but they could not afford the expense of bringing him from the city of his employment to testify, they could have applied pursuant to Rule 15 of our Rules of Practice to take his deposition, but they did not do so. Moreover, it is apparent from the lengthy testimony of Itin and other personnel of registrant regarding the Windsor offering that the syndicate manager was not the only person with knowledge of the pertinent facts.

Public Interest

In view of the willful violations we have found on the part of registrant, Itin, Campeau, and Owens, we must determine whether it is necessary or appropriate in the public interest or for the protection of investors to impose sanctions upon them.

Various factors have been urged in mitigation as warranting the imposition of no sanction or a lesser sanction than was imposed by the hearing examiner. Itin asserts

that he was inexperienced, that he frequently sought the advice of our staff and relied upon counsel, that he cooperated with our staff during the investigation, and that he and registrant have suffered expense, a loss of business, and damage to their reputations as a result of these proceedings. Campeau also cites the expense of these proceedings and the damage to his reputation and states that he has not been in the securities business since January 1965. Owens asserts that the Section 5 charges are "technical," that he was not aware he was committing any violation, that there is no evidence that any of the purchasers in the original offering were damaged, that he cooperated in our staff's investigation, and that he has suffered financial injury and damage to his reputation.

After careful consideration of these factors, we have determined that they are not sufficient to overcome the misconduct we have found. The extensive violations by registrant and Itin demonstrate gross indifference to the requirements of the securities laws and are inconsistent with their continued engagement in the securities business. Campeau, despite his responsibilities as registrant's executive vice-president and sales manager, personally made extravagant and unwarranted price predictions to customers. Owens failed to use due care to confine the sales of the Hamilton Life stock offering to residents, and we cannot agree with his characterization of the registration requirements of Section 5.

Moreover, these are not the only disciplinary proceedings against registration, Itin and Campeau. In 1966, we upheld the action of the NASD censuring them and fining registrant $1,700 for failure to comply with our net capital and bookkeeping requirements and to disclose to customers that registrant was acting for both the buyer and seller, and for unlawfully extending credit to

customers.[38] We note that most of these violations of the NASD's Rules of Fair Practice occurred during the period involved in the instant proceedings. In addition, in October 1964, Campeau's license as a salesman was suspended for 60 days by the Michigan securities commission, following a hearing before it, because he caused unissued stock of a broker-dealer firm of which he was president to be sold to persons other than those listed in his filing with that commission.[39]

Under all the circumstances, we agree with the hearing examiner that registrant's broker-dealer registration should be revoked and that it should be expelled from membership in the NASD and the Detroit Stock Exchange. We also conclude that Itin should be barred from association with a broker-dealer with the understanding that,

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[38] Securities Exchange Act Release No. 7950 (September 12, 1966). Campeau asserts that the findings against him in those proceedings should not be considered since he was not represented by separate counsel. However, we cannot attribute any mitigative effect to the fact that his counsel also represented the other respondents. He further asserts that since our decision was not introduced in evidence (it was issued after the hearings in the instant case), he had no opportunity to "explain or defend." But any defense should have been presented to the NASD and to us. See *Kaye, Real & Company, Inc.*, 36 S.E.C. 373, 375 (1955). In *R. H. Johnson & Company*, 36 S.E.C. 467, 487 (1955), *aff'd per curiam* 231 F. 2d 523 (C.A.D.C., 1956), *cert. denied*, 352 U.S. 844, we took official notice of other disciplinary action against the respondent, and on appeal, respondent unsuccessfully contended that in doing so we had improperly considered matter outside the record. See also *R. H. Johnson & Company*, 33 S.E.C. 180, 187 (1952), *aff'd* 198 F. 2d 690 (C.A. 2, 1952), *cert. denied*, 344 U.S. 855.

[39] Campeau asserts that the violation resulted from the state commission's advice to his attorney, and that a court action by him to enjoin enforcement of the suspension order was settled with the action being dismissed and the suspension being deemed to have run during a period when he was not engaged in the securities business.

upon an appropriate showing, he may become associated with a broker-dealer in a non-supervisory capacity after one year, subject to adequate training and supervision. However, we do not agree with the examiner that Campeau should be accorded leniency, and we conclude that he should be barred. Although Owens' transactions with respect to the Hamilton Life stock offering were sufficient to defeat the intrastate exemption, he was not shown to have engaged in any fraudulent activity, and these are the first disciplinary proceedings against him. We conclude that he should be censured. In view of our disposition of the issues in the case, the proceedings as to Reuter, Bruce and Safford will be discontinued.[40]

An appropriate order will issue.

By the Commission (Chairman COHEN and Commissioners OWENS, BUDGE, WHEAT and SMITH).

Orval L. DuBois
ORVAL L. DUBOIS
Secretary

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[40] The exceptions to the initial decision of the hearing examiner by the parties are overruled or sustained to the extent they are inconsistent or in accord with our decision.

APPENDIX A-4

Memorandum Opinion and Order on Petition for Rehearing and Stay, Dated December 27, 1968

ADMINISTRATIVE PROCEEDING
FILE NO. 3-336

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

December 27, 1968

[SAME TITLE]

Armstrong, Jones and Company ("registrant"), a registered broker and dealer, and Thomas W. Itin, its president, filed a petition for rehearing and supporting memorandum with respect to our Findings, Opinion and Order of October 3, 1968 (Securities Exchange Act Release No. 8420). In that decision we concluded among other things that, in the offer and sale of certain securities, registrant, together with or willfully aided and abetted by Itin, willfully violated the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933, and the anti-fraud provisions of Section 17(a) of that Act and Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 15c1-2, and 15c1-5 thereunder. We further found that registrant, willfully aided and abetted by Itin, willfully violated the record-keeping provisions of Section 17(a) of the Exchange Act

and Rule 17a-3 thereunder. We revoked registrant's broker-dealer registration and expelled registrant from membership in the National Association of Securities Dealers, Inc. ("NASD") and the Detroit Stock Exchange, and barred Itin from association with any broker-dealer. Our order as to Itin was subject to the proviso that, upon an appropriate showing, he may become associated with a broker-dealer in a non-supervisory capacity after one year, subject to adequate training and supervision. Our Division of Trading and Markets ("Division") filed a memorandum in opposition to the petition.

Petitioners challenge our conclusion that they willfully violated the registration provisions of Section 5 of the Securities Act. They challenge our finding that three transactions involving the purchase by non-residents of stock of Alexander Hamilton Life Insurance Company ("Hamilton Life"), which were effected prior to the commencement of trading, made unavailable a claimed intrastate exemption with respect to a public offering of that stock. They assert these transactions were not consummated by registrant. They further assert that registrant, which was a member of the selling group, and Itin had no knowledge of two of the transactions effected by respondent E. Keith Owens.

Petitioners also challenge our holding that an out-of-state distribution occurred when a part of the original offering was resold by resident subscribers shortly after registrant's commencement of trading in the stock. They assert that this assumes a resident purchaser in an intrastate offering must purchase for investment and cannot immediately resell in the after-market. They urge that the intrastate exemption provided by the Securities Act does not require that purchases be held for a period of time consonant with an investment representation. Our holding, they claim, would nullify the exemption. They argue it would be difficult or impossible to undertake an

intrastate offering to a great number of residents of a single state, since some of them would be certain to be interested in selling their securities in the after-market. Petitioners also stress that Itin acted on the advice of counsel in connection with the offering and did not intend to violate the law.

We found on the basis of the record that the resident-nominee who purchased Hamilton Life stock in the initial offering from Itin on behalf of non-residents sent the subscription agreement and check in payment to registrant, and that, as the examiner had also found, the circumstances were sufficient to put Itin on notice that the purported purchaser was acting on behalf of non-residents. And we did not attribute to petitioners any knowledge of the transactions involving non-residents which were effected by Owens (who owned the firm that underwrote the offering and was then a controlling person of registrant). Even apart from the responsibility of a registrant for the acts of its agents, under Section 15(b)(5) of the Exchange Act a sanction may be imposed upon a broker-dealer for willful violations committed by controlling persons or an officer of such broker-dealer.

Our findings with respect to the continuance of the distribution after the commencement of trading are not inconsistent with the statutory intrastate exemption. We concluded that on the facts before us petitioners had failed to discharge their responsibility to make sure that the offering did not become an interstate distribution through resales to non-residents. We were not suggesting that the exemption is affected where securities which have actually come to rest in the hands of resident investors, such as persons purchasing without a view to further distribution or resale to non-residents, are in due course resold to non-residents. But we deemed it significant, in considering

whether respondents had acted properly to limit the distribution to residents, that Itin solicited orders and indications of interest from non-residents during the initial offering, and that, at the commencement of trading, registrant's opening bid was substantially higher than the offering price, which tended to induce residents, who had presumably purchased for investment, to sell their stock and enable registrant to resell to non-residents. Moreover, as we have frequently held, neither reliance on the advice of counsel nor absence of an intention to violate the law can negate willfullness within the meaning of the securities laws.[1]

Petitioners also object to our finding that they failed to disclose to purchasers in the initial offering of Hamilton Life stock that the issuer and registrant were under common control. They assert that while Owens and two other respondents may have had, because of their stock ownership in registrant, the power to control registrant in a technical sense, they never actually controlled Itin, and that, in any event, there was no intent to conceal such control relationship. They note that the prospectus disclosed that Itin was an incorporator of Hamilton Life's parent company, that the brochure sent to the original subscribers to the offering contained a picture of Itin as one of "the men behind" Hamilton Life, and that "full disclosure of the common control relationship" appeared in the public files of the Detroit Stock Exchange and such relationship was "made known" by that exchange to every Michigan broker-dealer in the Hamilton Life initial offering. These assertions do not derogate from our findings that three respondents other than Itin had a control rela-

[1] See, *e.g.*, *Gearhart & Otis, Inc.*, Securities Exchange Act Release No. 7329, pp. 8, 34 (June 2, 1964), *aff'd* 348 F. 2d 798 (C.A. D.C., 1965).

tionship with respect to both Hamilton Life and registrant and that petitioners sold Hamilton Life stock to customers without disclosing to them, as required by our rules, that registrant and Hamilton Life were under common control.

Petitioners' primary concern is with the sanction imposed upon Itin. They assert that the proceedings were made public, over their objection, principally because of the allegation in the order for proceedings that they had manipulated the market in Hamilton Life stock. They interpret the fact that we did not reach that issue in our decision as indicating that the Division was unable to prove the manipulation charge, and they claim that in any event public knowledge of that charge had "in a real sense" already kept Itin out of the securities business for three years. They further assert that since Itin was not found to have made any fraudulent price predictions to customers, "presumably" the sanction was imposed upon him because Campeau and others were found to have made them.

We do not consider that the sanction against Itin was excessive. In determining to assess a sanction of less than a complete bar, we took into account among other things the nature and extent of his misconduct. Such sanction is hardly tantamount to a "life sentence", as Itin contends, since he is expressly permitted to reenter the securities business in a non-supervisory capacity after one year upon an appropriate showing.[3] Petitioners do not cite nor can we find anything in the record or in our minutes indicating that the proceedings were made public principally because of the manipulation charge. Manipulation was not the only fraudulent conduct charged in the case, and making the proceedings public was a proper exercise of discretion in view of the gravity of the charges and the substantial

[3] See *Melvyn Hiller*, Securities Exchange Act Release No. 8476 (December 24, 1968).

public interest in the subject matter of the hearings,[8] We did not find it necessary to our decision and as a basis for the sanctions imposed to determine the manipulation issue. Petitioners are not justified in presuming that Itin's sanction was based upon our finding that Campeau and others made fraudulent price predictions. Itin was not found to have made any, and we specifically disavowed any imputation to any one respondent of the violations committed by another. We imposed an unconditional bar upon Campeau, as compared to the conditional bar upon Itin.

Petitioners also claim that their violations of the NASD Rules of Fair Practice, which were found by the NASD and sustained by us in the 1966 decision to which we referred in the instant case, were the inevitable result of a changeover in registrant's bookkeeping from a manual to an automated system following Itin's takeover of the management of registrant. In that decision we upheld the NASD censure of petitioners and fine of registrant for failure to comply with our net capital, bookkeeping, and credit requirements, and to disclose to customers that registrant was acting for both the buyer and seller. We note that the mitigative factors now cited by petitioners in connection with that decision had been urged in the NASD review proceeding and had been considered by the NASD as well as us in determining the fairness of the sanctions there imposed.

Petitioners' remaining assertions and contentions were advanced previously and fully considered by us in issuing our decision of October 3, 1968, and need not be repeated here. After careful consideration of the issues raised, we have concluded that the petition for rehearing should be denied.

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[8] See *J. H. Goddard & Co., Inc.*, 41 S.E.C. 964, 965-66 (1964).

Petitioners also request leave to adduce unspecified additional evidence with respect to our findings and conclusions, and, if rehearing is denied, request a stay of our order as to them pending determination of a petition for judicial review to be filed by them or, in the alternative, for a period of 20 days so that they may apply to the Court for a stay pending appeal. Petitioners in effect are asking that the proceeding against them be relitigated, and we find that they have not made the requisite showing under 21(d) of our Rules of Practice that there were reasonable grounds for failure to adduce additional evidence at the hearings before the hearing examiner. Accordingly, such request must also be denied. We further conclude that a sufficient showing has not been made to warrant any stay of our order as to registrant. However, we will grant a stay of our order as to Itin pending determination of a petition for judicial review provided such petition is filed within 20 days after service of the order herein.

Accordingly, IT IS ORDERED that the petition of Armstrong, Jones and Company and Thomas W. Itin for rehearing, and their request for leave to adduce additional evidence be, and they hereby are, denied.

IT IS FURTHER ORDERED that the requests of Armstrong, Jones and Company for a stay of our Order of October 3, 1968 as to it be, and they hereby are, denied, and that the request of Thomas W. Itin for a stay pending determination of a petition for judicial review be, and it hereby is, granted provided such petition is filed by him within 20 days after service of this order.

By the Commission (Chairman Cohen and Commissioners Owens, Budge, Wheat and Smith).

ORVAL L. DUBOIS
Secretary

APPENDIX A-5

Order of United States Court of Appeals

No. 19291

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

ARMSTRONG, JONES AND COMPANY, and THOMAS W. ITIN,

Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ORDER:

Before: PECK and COMBS, Circuit Judges and BROWN, District Judge.

On Petition to review an order of the Securities and Exchange Commission,

This cause came on to be heard on the transcript of the record from the Securities and Exchange Commission, and was argued by Counsel.

On consideration whereof, it is now here ordered, adjudged and decreed by this Court that the order of the Securities and Exchange Commission be and it is hereby affirmed,

It is further ordered that respondent recover from Petitioners the cost on appeal as itemized below.

Entered by order of the Court.

CARL W. REUSS
Clerk

COST: NONE

Filed: January 23, 1970